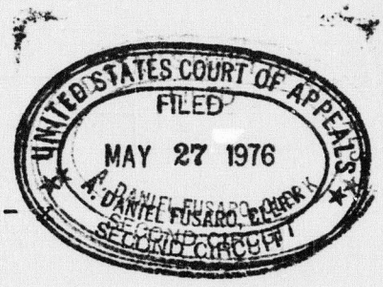
United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

76-5012



UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

IN RE: ORE CARGO, INC.,

Bankrupt

ISRAEL DISCOUNT BANK LIMITED,

Plaintiff-Appellant

Docket No. 76-5012

-v-

JACOB GOTTESMAN, Trustee in Bankruptcy
of Ore Cargo, Inc.

Defendant-Appellee.

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APPELLANT'S BRIEF

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**On Appeal from the United States District Court,
For the Southern District of New York**

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TABLE OF CONTENTS

AUTHORITIES CITED

CASES

STATUTES

Other

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

- -X

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DECISION APPEALED

Appeal is taken from a memorandum order of the Hon. Kevin T. Duffy, District Judge, affirming without opinion an unreported decision and order of the Hon. Asa S. Herzog, Bankruptcy Judge.

QUESTION PRESENTED

Under New York law, did a document purporting to grant a security interest in all claims of the bankrupt to the appellant bank effectively transfer to the bank an interest in tort claims entitling the bank to reclaim their proceeds from the bankrupt's trustee?

The court below answered "No."

STATEMENT OF THE CASE

This is an adversary proceeding under the Bankruptcy Rulesin the Southern District of New York in which the appellant Israel Discount Bank Limited (the "bank") sought to reclaim the sum of $20,968.16 from the appellee Jacob Gottesman, as Trustee in Bankruptcy of Ore Cargo, Inc. (the "trustee"). The trustee moved on the summons and notice of trial,complaint, affidavits and exhibits for summary judgment, which was granted by the bankruptcy court (Hon. Asa S. Herzog, Bankruptcy Judge). On review under Rule 801 of the Bankruptcy Rules, the District Court (Hon. Kevin T. Duffy, District Judge) affirmed without opinion, and this appeal followed.

Ore Cargo, Inc., a Liberian corporation, was owner of the Liberian flag vessel S.S. "JOHN CROSBY". The "JOHN CROSBY" collided with the vessel "HASLACH" in October, 1969. On January 15, 1971, Ore Cargo, Inc. borrowed $300,000 from the bank to refinance the vessel, delivering to the bank a

general security agreement (Appendix,p.2) a mortgage on the JOHN CROSBY, and other documents. No mention was made to the bank of the existence of any potential claim arising from the HASLACH collision. (See affidavit of John G. Manos, p. 2). In October, 1972, Ore Cargo, Inc. was adjudicated bankrupt and the trustee appointed. In July, 1973, the trustee recovered $28,976.16 on the bankrupt's claim against the HASLACH arising from the collision. The trustee expended $8,010 of this amount and still holds the balance, $20,968.16, the subject matter of this proceeding. The bank discovered in 1974 that the trustee was holding these funds, demanded them, was refused, and brought this proceeding.

ARGUMENT

THE BANK OBTAINED A VALID SECURITY INTEREST IN THE MONEY HELD BY THE TRUSTEE.

The appellant bank claims that it has a perfected security interest in various assets of the bankrupt, including the proceeds of its tort claims, and that the bank is therefore entitled to reclaim from the trustee the money he holds as proceeds of a claim against the S.S. "HASLACH" arising from a collision at sea.

The bank relies on the following language of the general security agreement delivered to it by the bankrupt January 15, 1971;

> "2. As security for the repayment of the obligations, the undersigned hereby grant(s) to the Bank a security interest in, a general lien upon and/or right of set-off of, all personal property and fixtures of the undersigned, whether now or hereafter existing or now owned or hereafter acquired and wherever located, of every kind and description, tangible or intangible, including, but not limited to, the balance of every deposit account, now or hereafter existing, of the undersigned with the Bank and any other claim of the undersigned against the Bank, now or hereafter existing, and all money, goods, instruments, securities, documents, chattel paper, accounts, contract rights, general intangibles, credits, claims, demands and any other property, rights and interests of the undersigned, and the proceeds, products and accessions of and to any thereof (all of which property is hereinafter referred to as the "Security")." (Appendix p.2)

Deleting language not directly pertinent to this situation, the clause provides:

> "...[T]he undersigned hereby grant(s) to the Bank a security interest in . . . all personal property. . . of the undersigned . . . of every kind and description tangible and intangible, including . . . all. . . general intangibles, credits, claims, demands and any other property, rights and interest of the undersigned, and the proceeds. . . thereof. . . ." (Appendix p.2)

The bank submits that this language gave it a security interest in all the bankrupt's claims, including

tort claims such as the collision claim arising from the HASLACH collision, and the proceeds thereof.

The trustee has conceded (affidavit of Mr. Wexelbaum, in support of motion, p. 6) for the purposes of his motion that the bank duly filed under the Uniform Commercial Code with respect to the security interest, if any, created. The trustee contends that no security interest was created, because Article 9 of the Uniform Commercial Code excludes tort claims from its ambit, in the following language:

> "§9-104. Transactions excluded from Article. This Article does not apply. . .
> (k) to a transfer in whole or part of any of the following: any claim arising out of tort;. . ."

The Bank concedes that this language is directly applicable to the facts. The bankrupt's claim against the HASLACH arose out of tort; the bank's claim to the proceeds of the HASLACH claim depends on the effective transfer to the bank of an interest in the claim itself.

In discussing the effect of the general security agreement, Bankruptcy Judge Herzog said:

> "The general security agreement was a typical U.C.C. agreement and the trustee concedes that it was filed pursuant to the provisions of the U.C.C. However, a tort claim is not perfected by a U.C.C. filing since it is not subject to a U.C.C. security interest." [Appendix, pp. 28-29]

He then quoted Professor Gilmore's discussion of U.C.C. §9-104(k):

> ". . . Such transfers are beyond the pale with respect to a statute devoted to commercial financing. The pre-Code common law of assignment or pledge will continue to apply to the excluded transfers; . . . Gilmore, Security Interests in Personal Property, Vol. I, p. 316 (1965)." (Appendix, p.29)(Emphasis added by the Bankruptcy Judge.)

After quoting a portion of paragraph 6 of the general security agreement, commencing:

> "The Bank shall have the rights and remedies with respect to the security of a secured party under the Uniform Commercial Code (whether or not the code is in effect in the jurisdiction where the rights and remedies are asserted). In addition. . . ." (Appendix, p. 3 , quoted at Appendix, p.29) the Bankruptcy Judge held:

> "Nowhere does the document contain an assignment to [the bank] of a tort claim, nor may such an assignment be inferred. As a matter of law without such assignment no security interest vested. The security interest vested thereunder was strictly such as was or would be subject to the provisions of the Uniform Commercial Code and as hereinabove noted, the proceeds of the tort claim are not subject to perfection or U.C.C. security interests.
>
> "I do not find from anything contained in the instrument that the drafter contemplated the inclusion of a tort claim and consequently, [the bank] must

look elsewhere for the assignment it seeks to establish." (Appendix, pp.30-31)

The bank contends that in this analysis, the Bankruptcy Judge erred. The bank concedes that the general security agreement does not contain an "assignment" sufficient under the "pre-code common law of assignment or pledge;" nothing in the general security agreement purports to transfer to the bank title, or "the entire interest of the assignor in the particular subject of assignment, whereby the assignor is divested of all control over the thing assigned," Coastal Commercial Corporation v. Samuel Kosoff & Sons, Inc., 10 A.D. 2d 372, 376, 199 NYS 2d 852, 855, quoting 3 N.Y. Jur., Assignments, §28. The bank also concedes that it cannot "look elsewhere" than the general security agreement for documents supporting its right to reclaim these collision-claim proceeds.

The bank disagrees with the Bankruptcy Judge's conclusion that the draftsman of the general security agreement did not contemplate the inclusion of tort claims in the security conferred by the general security agreement. While not using the word "tort," the draftsman did include

"claims, demands and any other property, rights and interests," (Appendix, p. 2), as part of the "personal property. . . of every kind and description tangible and intangible" in which a security interest was being granted. Tort claims are "claims," and perhaps "demands," as well as being personal property. Moreover, the draftsman specially mentioned "contract rights" as one species of such property; if he intended to limit the scope of the language to contractual rights only he could easily have done so. The bank submits that the language was plainly intended to include all types of personal property, not to exclude any, and that tort claims, being one type of such property and a type aptly included by the words used, are included in the property in which the general security agreement grants a security interest.

The Bankruptcy Judge mentioned the need for an intent to assign (Appendix, pp. 32-33). Assuming that an intent on the part of the bankrupt is equally necessary to grant a security interest, such intent is apparent from the general security agreement. The fact that the existence of this particular tort claim was not disclosed to the bank is irrelevant; there is no need to specify the particular

items subject to a security interest, and in this, as in many or most such situations, it is quite impossible to do so as the interest covers rights and property not yet in existence or acquired.

The bank further submits that it was error for the Bankruptcy Judge to conclude that the interests intended to be given the bank by the general security agreement were strictly limited to interests included in Article 9 of the Uniform Commercial Code. The language quoted by the Bankruptcy Judge about "rights and remedies. . . of a secured party. . . (whether or not the Code is in effect. . .)" (Appendix, p. 3 , quoted above, p. 6) shows that the agreement was intended to have a broader scope than the Code itself. Moreover, the general security agreement, at paragraph 2(Appendix, p. 2 , quoted above, at p.4) grants the bank a right of set-off, which is excluded from Article 9 by §9-104(i). Finally, the use of the term "security interest" in the general security agreement is consistent with an intention to include interests not enforceable under Article 9; the term is defined in Article 1 of the Code, General Provisions, as follows:

> "'Security Interest' means an interest in personal property or fixtures which secures payment or performance of an obligation. . . ." Uniform Commercial Code §1-201 (37).

Section 9-104 of the Code itself recognizes that security interests may exist but be excluded from Article 9; it begins:

> "§9-104. Transactions excluded from Article. This Article does not apply
> (a) to a security interest subject to any statute of the United States. . . ."

In summary, therefore, the bank contends that the language of the general security agreement was entirely apt to give it a security interest in this tort claim and its proceeds. It remains to be considered whether the Bankruptcy Judge was correct that no such interest in a tort claim can be created except by assignment.

The reason stated in the Official Comment to Section 9-104 of the Code for the exclusion of tort claims, as well as of judgments and set-offs, from article 9 is somewhat unhelpful:

"8. The remaining exclusions go to other types of claims which do not customarily serve as commercial collateral: judgments under paragraph (h), set-offs under paragraph (i) and tort claims under paragraph (k)." Uniform Commercial Code, §9-104, Official Comment, 8.

Surely the fact that a particular type of transfer may be unusual is not of itself a sufficient reason to exclude it from a general statute. There must be counter-vailing considerations. Some exclusions of §9-104 reflect situations in which there is either a federal statute or a settled body of other law (e.g. clauses (a) - ship mortgages, (e) - railway equipment trusts, and (g) - insurance policies); the rest appear to reflect deference to local policies or practices where the local policy may be strong, or the need for uniformity weak, or both, as is expressly stated in the Official Comments to § 9-104 at 3 and 4, relating to clauses (c) - liens for services or materials, and (d) - wage assignments.

In the case of judgments, where as with tort claims the official comment is silent as to the possible conflicting local concerns, it is clear that such problems were relevant. The 1956 Report of the New York Law Revision Commission on the Uniform Commercial Code, in the Appendix thereto relating to other laws requiring amendment, discusses potential problems created by Article 7 of the Public Housing

Law which provides for transfers of interests in condemnation awards to be filed with the condemning agency. 1956 Report of the Law Revision Commission, pp. 217-218. As local procedures for the recordation of transfers of interests in judgments could be called into question unless such transfers were excluded from Article 9, and as local policies governing wage assignments could be disrupted by their inclusion under Article 9, so local policies about tort claims could be impinged upon unless such transfers were excluded. Many states restrict or prohibit the transfer of interests in personal injury tort claims, as New York does in General Obligations Law § 13-101. Some states also prohibit the transfer of other tort claims, e.g. New Jersey, East Orange Lumber Company v. Christian Feiganspan, 120 NJL 410, 199 Atl. 778 (Supreme, 1938), affd 124 NJL 127, 10 A.2d 732 (Errors & Appeals, 1940).

The bank submits that the exclusion of judgments and tort claims from Article 9 rests not only on their relative unimportance, but also on the reasonable judgment of the draftsmen of the Uniform Commercial Code that attempting

to make transfers of interests in judgments and tort claims subject to uniform rules would involve considerable needless controversy and complications in view of local differences. If this view is correct, the exclusion of tort claims from Article 9 was a matter of convenience, not the result of any legislative or other determination that some other policy required their exclusion in any particular case.

In this case, involving the law of New York and a claim for property damage, no reason appears why a security interest in such a claim cannot be created. The General Obligations Law suggests the contrary:

> "§13-101. Transfer of Claims.
> Any claim or demand can be transferred, except in one of the following cases:
> 1. Where it is to recover damages for a personal injury...."
> New York General Obligations Law §13-101.

Under the pre-code common law, an assignment of a chose in action could be made without any filing or notification, Malone v. Bolstein, 151 F. Supp. 544 (N.D. N.Y. 1957), affirmed 244 F.2d 954, and could be made by parol, Williams v. Ingersoll 89 N.Y. 508 (1882). Consequently, holding that a written general security agreement

suffices to transfer an interest in a property damage claim will not conflict with any expressed policy of New York requiring some other type of formality for such a transfer, nor with any purpose of the Code. The document shows that such a transfer was intended; such a transfer is lawful and no particular formality is required. The General Security Agreement should be enforced in accordance with its terms.

Finally, the law of New York is clear that when the legislature adopts a new, general law that displaces the common law over a wide area, the new statutory rule applicable to most cases should be applied to cases outside the statute that would have been treated alike under the common law. In Agar, et al, v. Orda, 264 N.Y. 248, 190 N.E. 479 (1934) the Court of Appeals held that the remedies of a seller of shares of stock (a "thing in action") should be limited to those available to a seller of goods under the Uniform Sales Act, and did not permit the common law action for the price that was available to a seller of goods or things in action before adoption of the act:

"Prior to the enactment of the Sales Act, the courts held that a seller of personal property had the same remedies, regardless of the nature of the personal property. . . The rule has been shattered by the Legislature. It no longer can be applied to contracts for the sale of 'goods', and goods, as defined by the statute, include 'all chattels personal other than things in action and money.' Section 156. The problem is whether a fragment of the shattered rule still persists and is applicable to sales of certificates of stock.

* * * *

. . . By limiting the application of the statutory code to the sale of 'goods' the Legislature gave no indication of what rule the courts should apply to the sale of other personal property. That problem it left to the courts.

The courts must formulate the rules applicable in cases not covered by the statute. The field is narrow. Inherent differences between 'goods' and things in action may require at times the formulation of different rules. Perhaps that is why the Legislature excluded things in action from the scope of the statutory rules. No such differences exist here. Indeed, before the Sales Act was adopted, the courts applied the rule governing actions for the price of goods to actions for the price of other personal property because they found that logic and policy alike dictated that here no distinction should be drawn. The same considerations still apply now that the court is called upon to formulate the rule which shall be applied in cases not covered by the Sales Act." 264 N.Y. 248, 250-252.

In this case, the rules of the Uniform Commercial Code regulating the creation of security interests have "shattered" the various common law rules of assignment, pledge and the like. This general security agreement was doubtless sufficient to transfer a security interest in contract rights, accounts, etc.; no reason appears why a different rule should be applied to a transfer of a property damage claim, which was treated like a transfer of a contract claim under the common law and the General Obligations Law, § 13-101. By holding that a security interest in a tort claim could not be created by such an agreement, but only by a common law assignment, the Bankruptcy Judge in effect created a special rule with special requirements for tort claims, although no policy of the Uniform Commercial Code and no policy of New York requires special treatment and, in view of the lack of filing or formality required at common law, no creditors of the transferor will be protected thereby. In this the bank submits that the Bankruptcy Judge was in error.

CONCLUSION

For the reasons stated, the order of the District Court which affirmed the order of the Bankruptcy Judge granting summary judgment to the defendant and dismissing the complaint herein should be reversed.

Respectfully submitted,

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